FEB 13 2003

No. 02-1069

IN THE

Supreme Court of the United States

DAVID JAROSLAWICZ and JAROSLAWICZ & JAROS,

Petitioners,

v.

UNITED DIAGNOSTIC, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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Questions Presented

The questions presented concern the applicability and interpretation of the sanctions provisions (§ 78u-4(c)) of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4 *et seq.*, and Fed. R. Civ. P. Rule 11.

1. Where a complaint under the federal securities laws contains both Rule 11-frivolous and Rule 11-nonfrivolous claims, what test should the courts use to determine whether there has been a "substantial failure" of that complaint to comply with Rule 11 in order to invoke the presumption under the PSLRA that sanctions will equal the full amount of the attorneys' fees and other expenses incurred in the action?

2. May an award of sanctions under the PSLRA include, as part of the attorneys' fees and other expenses incurred in the action, the fees and other expenses of appellate proceedings and those incurred in pursuit of the sanctions award, whether in the district or appellate courts?

Parties to the Proceeding (Rule 14.1(b))

The petition does not correctly identify the petitioners. Mordechai Gurary, named as petitioner, was the plaintiff in the action instituted in the district court. The petition seeks review of a judgment of the court of appeals (*Gurary v. Nu-Tech Bio-Med, Inc.*, 303 F.3d 212 (2d Cir. 2002)), imposing sanctions on Gurary's counsel, pursuant to Fed. R. Civ. P. Rule 11(b) and Section 21D(c)(3)(A)(ii) of the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 *et seq.* Gurary is not an aggrieved party by reason of this judgment, and therefore not properly a petitioner. Gurary's counsel, David Jaroslawicz and his law firm, Jaroslawicz & Jaros, are the only persons aggrieved by the judgment, and the only proper petitioners here. *See Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 335 (1980).

The petition also does not accurately denote the respondent. Nu-Tech Bio-Med, Inc., designated as respondent in the petition, no longer exists and did not exist at the time of the proceedings and judgment in *Gurary v. Nu-Tech Bio-Med, Inc.*, 303 F.3d 212 (2d Cir. 2002). United Diagnostic, Inc., is the successor by corporate merger to Nu-Tech Bio-Med, Inc.

The caption of this brief in opposition has been modified to reflect the foregoing.

Corporate Disclosure Statement (Rule 29.6)

United Diagnostic, Inc., named respondent in this brief in opposition, is a Delaware corporation whose securities are publicly-held but not currently listed on any securities exchange. It has no publicly-owned corporate parents, subsidiaries, or affiliates. As noted in the foregoing Rule 14.1(b) Statement, United Diagnostic, Inc. is the successor-in-interest by corporate merger to one of the original defendants in the case, Nu-Tech Bio-Med, Inc.

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Preliminary Statement

United Diagnostic, Inc. ("UDI") opposes the petition for a writ of certiorari of David Jaroslawicz and Jaroslawicz & Jaros (collectively, "Jaroslawicz"). Jaroslawicz seeks the writ to review a judgment awarding UDI sanctions equal to its attorneys' fees and other expenses incurred in this case under the sanctions provisions of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4 *et seq.* The court of appeals decision is reported as *Gurary v. Nu-Tech Bio-Med, Inc.*, 303 F.3d 212 (2d Cir. 2002) ("*Gurary III*"), and is the third decision issued by that court in this case. This Court has denied Jaroslawicz's earlier petition for *certiorari*.[1]

As more fully demonstrated below, there is no circuit conflict here, and the court of appeals' decision is both fully consistent with this Court's precedents and in all respects correct. *Certiorari* is unwarranted.

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[1] Citations of reports of the decisions in this case are: *Gurary v. Nu-Tech Bio-Med, Inc.*, 303 F.3d 212 (2d Cir. 2002); *Gurary v. Winehouse*, 235 F.3d 792 (2d Cir. 2000), *cert. denied sub nom. Gurary v. United Diagnostic, Inc.*, 534 U.S. 826 (2001); *Gurary v. Winehouse*, 190 F.3d 37 (2d Cir. 1999); *Gurary v. Winehouse*, 153 F. Supp. 2d 489 (S.D.N.Y. 2001); Gurary v. Winehouse, No. 97CIV3803, 2000 WL 20706, at *1 (S.D.N.Y. Jan. 12, 2000); and Gurary v. Winehouse, No. 97CIV3803, 1998 WL 54641, at *1 (S.D.N.Y. Feb. 10, 1998).

STATEMENT OF THE CASE

A. The Central Theories of the Case and the Prior Proceedings in the Lower Courts.

This case arises out of four purchases by Mordechai Gurary, the plaintiff, of publicly-traded common stock of Nu-Tech Bio-Med, Inc. ("Nu-Tech"), UDI's predecessor. Gurary asserted claims for securities fraud under Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. He named as defendants Nu-Tech, and the so-called Winehouse defendants, who were holders of Nu-Tech convertible preferred stock. Gurary's theory was that the Winehouse defendants engaged in manipulative short selling, and then profited by "covering" their short sales with common stock obtained through the conversion of their convertible preferred positions.[2] (App. 166-73)

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[2] "A short sale involves a seller agreeing to sell stock it does not own. . . ." *United States v. Russo*, 74 F.3d 1383, 1388 (2d Cir. 1996). To profit, the seller must "cover," that is, buy stock at a price lower than the sale price and satisfy the short sale by making delivery on the contract to sell. *See* DICTIONARY OF FINANCE AND INVESTMENT TERMS 82 (2nd ed. 1987). In this case, according to the complaint, the Winehouse defendants had a ready source of "cheap" common stock to "cover" their short sales because the conversion of their convertible stock was at a discount to market.

Gurary did not allege that Nu-Tech was either a direct or indirect participant in this scheme. Instead, he asserted in his complaint that Nu-Tech committed securities fraud in failing to disclose publicly what it allegedly knew of the Winehouse scheme, and on appeal that Nu-Tech was liable because its president fraudulently promised Gurary that he would frustrate the scheme. (App. 169 ¶ 13; App. 177-78 ¶¶ 47-52) The district court dismissed his complaint (App. 1-8), and that dismissal was upheld on appeal. *See Gurary v. Winehouse*, 190 F.3d 37 (2d Cir. 1999). The district court denied Rule 11 sanctions on remand, and Nu-Tech appealed from that denial. (App. 35)

On appeal, in *Gurary v. Winehouse*, 235 F.3d 792 (2d Cir. 2000), *cert. denied sub nom. Gurary v. United Diagnostic, Inc.*, 534 U.S. 826 (2001), the court reversed and held that Gurary's counsel Jaroslawicz had violated Fed. R. Civ. P. 11(b). Because two of Gurary's four securities purchases were not "in connection with" any alleged fraud, the court found that the claims based on them were irredeemably frivolous for Rule 11(b) purposes. *Id.* at 799. The court further held that the claims based on the other two purchases—those earlier dismissed for failure to demonstrate the foundation requirements of reliance and damages—were virtually entirely lacking in merit, but nonetheless did not violate Rule 11. *Id.* at 801. On remand for the imposition of sanctions, the district court refused to apply the PSLRA sanctions presumptions for full fees and costs strictly, and only awarded UDI sanctions equal to one-half of its fees and expenses incurred. Jaroslawicz appealed, and UDI cross-appealed.

B. The Decision in *Gurary III*.

The complaint that Jaroslawicz filed on behalf of Gurary was subject to the pleading, sanctions, and other requirements of the PSLRA. In the case of a "substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure," those sanctions provisions impose a presumption that the courts shall award to the opposing party "the reasonable attorneys' fees and other expenses incurred in the action." 15 U.S.C. § 78u-4(c)(3)(A)(ii). That presumption may be rebutted only upon proof that "the violation . . . was *de minimis*" or that the sanctions "will impose an unreasonable burden on [the sanctioned] party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed." 15 U.S.C. § 78u-4(c)(3)(B)(i).[3]

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[3] Congress enacted the PSLRA to address serious abuses in private securities litigation. An integral part of the statute was a new sanctions regime, motivated by the recognition that "[e]xisting Rule 11 has not deterred abusive securities litigation." H.R. CONF. REP. NO. 104-369, at 39 (1995), *reprinted in* 1995 U.S.C.C.A.N. 731. Congress intended this new regime to "encourage defendants to fight abusive [securities] claims" and "to compensate wholly victims of frivolous litigation." *Gurary III*, 303 F.2d at 225, citing S. REP. NO. 104-98 (1995), reprinted in 1995 U.S.C.C.A.N. 683, and H.R. CONF. REP. NO. 104-369 (1995), reprinted in 1995 U.S.C.C.A.N. 738.

The *Gurary III* court answered one central question: what is the meaning of a "substantial failure" to comply with Rule 11 for purposes of the PSLRA sanctions regime in circumstances where some, but not all, of the claims asserted were Rule 11-violative. The court held that a "substantial failure" exists "whenever the nonfrivolous claims that are joined with frivolous ones are insufficiently meritorious to save the complaint as a whole from being abusive." *Gurary III*, 303 F.3d at 222. The court explained, "[u]nder this interpretation, the district court must examine the qualitative substance of the nonfrivolous claims in order to assess whether these claims were, in fact, legitimate filings that had the potential of prevailing or whether they patently lacked merit and only narrowly avoided being deemed frivolous themselves." *Id.* The inquiry is whether the nonfrivolous claims are of a "quality sufficient to make the suit as a whole nonabusive and the Rule 11 violation not substantial." *Id.* at 223.

Relying on its prior determinations that two of the claims asserted were Rule 11-frivolous and that the other two, while not frivolous, "patently lacked merit," the court held that the complaint here "substantially failed" to meet Rule 11 requirements. *Id.* at 224. The court rejected Jaroslawicz's contention that the "nonfrivolous" claim under Rule 11 (the claim, asserted only in response to the motion to dismiss and on appeal, that Nu-Tech's president fraudulently assured Gurary that he would frustrate the Winehouse defendants' scheme) saved the complaint. The court held that "[t]he legal strength, or lack thereof, of the possibly cognizable claim that was not presented in

the complaint, and that was itself unlikely to succeed on the merits, cannot suffice to relieve the present complaint from being an unfounded action *as a whole.*" *Id.* (emphasis in original).[4]

Turning to the subsidiary question on appeal, the court held that sanctions properly included the attorneys' fees and other expenses of appellate proceedings, as well as those incurred in pursuing sanctions. The court noted that the statutory language "support[s] a reading that permits the fees and expenses incurred in pursuing the sanctions to be included in the award," and as a result that it was proper to include appellate fees and costs since they are a component of the fees and costs incurred in seeking sanctions. *Id.* at 225. The court observed that the inclusion of both these categories was consistent with the purposes of the statute to "encourage defendants to fight abusive claims," and to compensate the victims of such claims. *Id.*[5]

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[4] As to the PSLRA rebuttal defenses, the court rejected the contention that the violation was *de minimis*, and held that Jaroslawicz had failed to carry his evidentiary burden of proving that imposition of the full amount of fees and costs would impose an "unreasonable burden." *Id.* at 225.

[5] Chief Judge Walker's separate concurrence also pointed out that the ordinary language of the statute, as well as the interpretation given similar language in other cases, supported inclusion of appellate and sanctions-seeking fees and expenses in the award. *Id.* at 231.

Based on these holdings, the court of appeals remanded with instructions to determine the precise amount of the sanctions. The court of appeals denied panel rehearing and rehearing *en banc* (App. 127-28), and Jaroslawicz filed this petition.

REASONS FOR DENYING THE WRIT

Petitioners' central claim—that there is a conflict between *Gurary III* and *Oxford Asset Mgmt., Ltd. v. Jaharis*, 297 F.3d 1182 (11th Cir. 2002)—is spurious. It is based at best on a misguided attempt to extract a principle or rule from the Eleventh Circuit case, but under any fair reading that case only refers to an inapplicable section of the PSLRA, and enunciates no rule or interpretation that could conflict with the Second Circuit. Moreover, the questions of federal law answered in *Gurary III* arise under a relatively new statute that has not been extensively litigated, and there is thus no good reason for review here at this time. Nor, finally, is there any conflict between the interpretations given to this statute by the court of appeals below and this Court's relevant precedents.[6]

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[6] Petitioners' framing of the first question misstates the holding of the court of appeals. That court did not hold that the complaint was "partially frivolous and partially not frivolous." Petition at 9. It held instead, "we find no plausible, nonfrivolous allegation in the complaint against Nu-Tech that saves it from being rightly viewed as an abusive securities lawsuit." *See Gurary III*, 303 F.3d at 224.

A. There Is No Circuit Conflict Here.

While *Oxford*, as did *Gurary III*, concerned a complaint in which some claims were frivolous and others nonfrivolous for Rule 11 purposes, the issue before the *Oxford* court was not the same issue as that presented in *Gurary III*. In reaching its Rule 11 determination, the district court in *Oxford* assessed the complaint as it had originally stood, and refused to consider whether an amended claim presented for the first time at the dismissal hearing, prevented the complaint from being viewed as Rule 11-violative. *Id.* at 1194-95. The issue before the Eleventh Circuit, accordingly, was whether this refusal was an abuse of discretion. The court of appeals held that it was an abuse of discretion to refuse to consider the claim just because it had been advanced at the dismissal hearing, and also that the claim so advanced had factual support and did not violate Rule 11. *Id.* at 1195. The court remanded for reexamination of the sanctions award in light of that holding.

The court had no occasion to consider the question presented in *Gurary III*, and did not do so. Its abbreviated observations as to the standard to be followed on remand are mere *dicta*, and do not establish that its determinations are in conflict with those of the Second Circuit. Equally, those observations are simply wrong. The court referred to the correct section of the PSLRA, but in doing so it conflated the presumption applicable to cases in which the Rule 11 violation arises from an offending answer or dispositive motion with that which applies when the offending paper is a complaint. 297 F.3d at 1194 (noting that 15 U.S.C. § 78u-4(c) "provide[s] for a

presumption that the proper sanction for a Rule 11(b) violation is an award . . . of the reasonable attorney's fees and costs *incurred as a direct result of the violation*")(emphasis added). While § 78u-4(c)(3)(A)(i) so provides, in the case where the offending pleading is a complaint, the presumption is an express one in favor of the full "attorneys' fees and other expenses *incurred in the action.*" *See* 15 U.S.C. § 78u-4(C)(3)(A)(ii) (emphasis added).

Because *Oxford* involved sanctions based on an offending *complaint*, its reference to the provision dealing with answers and dispositive motions—to sanctions measured by the fees and expenses incurred as a direct result of the violation—misreads the statute. Neither this misreading, nor the attempt by Jaroslawicz to discern a rule where none appears, suffices to establish any conflict between the Second and Eleventh Circuits. The most that can be said is that the Eleventh Circuit was wrong, that it imperfectly understood and improperly cited the PSLRA, and that its determination should be clarified to avoid the compounding of an error. It cannot be said that the Eleventh Circuit conducted a substantive examination of the PSLRA sanctions provisions that resulted in a conflict with the Second Circuit. *Certiorari* with respect to the first question presented would accordingly be improvident.[7]

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[7] Even if there *were* any conflict, it is not ripe. *Certiorari* would violate the Court's "policy of letting tolerable conflicts go unaddressed until more than two courts of appeals have

(Continued...)

B. There Is No Basis For Review of the Second Question Presented.

Nor does the approval by the Second Circuit of inclusion in PSLRA sanctions awards of attorneys' fees and expenses of appellate proceedings and of those incurred in the pursuit of sanctions merit review in this Court. Absent the PSLRA, it would be axiomatic that Rule 11 governs sanctions for frivolous *claims*, while Fed. R. App. P. Rule 38 governs sanctions for frivolous *appeals*. Ordinarily, it would be improper for a district court to impose sanctions that include the fees and expenses of appellate proceedings, because whether those proceedings are "frivolous" is a decision given to the courts of appeals. *See Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 406-09 (1990) (Rule 11 sanctions recoverable only for activities in the district courts, not on appeal). But by authorizing the district courts to award sanctions for abusive securities complaints measured by attorneys' fees and expenses "incurred in the action," the PSLRA effected a change in this division of powers between the district courts and the courts of appeals. The ordinary meaning of the language chosen here by Congress authorizes an award measured by the expense of the entirety of the

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considered a question." ROBERT L. STERN, ET AL., SUPREME COURT PRACTICE 229 (8th ed. 2002), quoting Justice William Brennan, *Some Thoughts on the Supreme Court's Workload*, 66 JUDICATURE 230, 233 (1983). *See also McCray v. New York*, 461 U.S. 961 (1983) (rejecting *certiorari* where conflict not sufficiently developed).

proceedings that follow from the filing of an abusive complaint, including appellate proceedings.

Stated differently, under the PSLRA sanctions regime the *only* inquiry is into the foundation pleading in the case, the complaint. Once that pleading is found deficient—"unfounded and abusive" (*Gurary III*, 303 F.3d at 226), the attorneys' fees and expenses that it sets in motion, those incurred "in the action," are recoverable as sanctions. Those include the fees and expenses of all stages of an action. The PSLRA neither authorizes nor requires any assessment as to whether appellate proceedings were separately frivolous, for none is necessary.[8]

The inclusion in such awards of the fees and expenses attributable to appellate proceedings is also justified by classifying such fees and expenses as incurred in the pursuit of sanctions. "The statutory language can support a reading that permits the fees and expenses incurred in pursuing the sanctions to be included in the award." *Gurary III*, 303 F.3d at 225.

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[8] *Cooter & Gell* is not to the contrary. In that case, the Court sought to rationalize Rule 11 and Rule 38, noting that they are "better read together as allowing expenses incurred on appeal to be shifted onto appellants only when those expenses are, themselves, caused by a frivolous appeal, and not merely because a Rule 11 sanction upheld on appeal can ultimately be traced to a baseless filing in district court." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. at 407. But the PSLRA is an explicit Congressional direction to do just that in the case of abusive private securities actions.

The fees and costs of appellate proceedings are a component of the fees and expenses incurred in the pursuit of sanctions. Their disallowance would "undermine the PSLRA's statutory purpose" to encourage defendants to fight abusive securities cases and to compensate them fully for the economic cost of doing so. This is directly shown by the extensive and expensive appellate proceedings in this case, virtually all of which were concerned with the sanctions application. *Gurary III*, 303 F.3d at 225.

The "ordinary meaning of the [PSLRA] text" and the "meaning ascribed to similar language as used in similar statutes," support this conclusion. *Id.* at 231. "Action" has been defined to "include[ ] all the formal proceedings in a court of justice attendant upon the demand of a right made by one person of another . . . , including an adjudication upon the right and its enforcement or denial by the court." *Id.*, citing BLACK'S LAW DICTIONARY 26 (5th ed. 1979). The language is thus broad enough to encompass appellate proceedings as well as proceedings in the court of first instance.

Likewise, the interpretation given to the language of the PSLRA by the court of appeals here is supported by the interpretation given to similar statutory language by *this* Court. For example, in *Comm'r, INS v. Jean*, 496 U.S. 154, 158 (1990), the Equal Access to Justice Act, 28 U.S.C. § 2412(d)(1)(A), provided for an award of "fees and other expenses . . . incurred by [a] party in any civil action." This Court held that the language was broad enough to include an award of expenses incurred in pursuing such fees (*id.* at 161-62), and that the language "in any civil

action" does not refer to "separate parts of the litigation, such as discovery requests, fees, or appeals". *Id.* at 159. The same rationale supports the Second Circuit's rule here.[9]

In sum, all traditional bases for review in this Court are lacking as to the second question presented, the decision of the court of appeals was correct, and *certiorari* would accordingly be improvident.

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[9] Jaroslawicz has presented a third purported question—whether the sanctions regime of the PSLRA applies to non-class, or individual, securities actions. This question is not addressed in the body of his petition, but is not in any event worthy of *certiorari*. Subsection (a) of the PSLRA applies to "*class actions*," and deals with rules applicable to them. 15 U.S.C. § 78u-4(a) (emphasis added). The other subsections of the PSLRA, including the sanctions provisions of subsection (c), apply by their express terms to "*any private action arising under*" the securities laws. See 15 U.S.C. § 78u-4(c) (emphasis added). The text of the statute fully answers this purported "certworthy" question.

CONCLUSION

For the reasons given above, the Court should deny the petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX

Statutory Appendix—15 U.S.C. § 78u-4(c)

(c) Sanctions for Abusive Litigation. —

(1) Mandatory Review by Court. – In any private action arising under this title, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

(2) Mandatory Sanctions. – If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

(3) Presumption in Favor of Attorneys' Fees and Costs.

(A) In General. – Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction –

(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11(b) of the Federal Rules

of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

(B) Rebuttal Evidence. The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that –

(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was *de minimis*.

(C) Sanctions. – If the party or attorney against whom sanctions are to be imposed meet its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.